

1 UNITED STATES BANKRUPTCY COURT
2 SOUTHERN DISTRICT OF NEW YORK

3 Case No. 09-01161-smb

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5 In the Matter of:

6 IRVING H. PICARD,

7 Plaintiff,

8 v.

9 KINGATE GLOBAL FUND, LTD., ET AL,

10 Defendants,

11 - - - - - x

12 Case No. 09-01364-smb

13 IRVING H. PICARD, TRUSTEE FOR THE LIQUIDATION OF B,

14 Plaintiff,

15 v.

16 ALPHA PRIME FUND LIMITED, ET AL,

17 Defendants.

18 - - - - - x

19 Case No. 10-05418-smb

20 IRVING H. PICARD, TRUSTEE FOR THE LIQUIDATION OF B,

21 Plaintiff,

22 v.

23 ROBERT L. SILVERMAN, ET AL,

24 Defendants.

25 - - - - - x

1 - - - - - x

2 Case No. 14-02408-smb

3 CAPITAL GROWTH COMPANY, DECISIONS, INC., ET AL,

4 Plaintiffs,

5 v.

6 PAMELA GOLDMAN, ET AL,

7 Defendants.

8 - - - - - x

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11 United States Bankruptcy Court

12 One Bowling Green

13 New York, New York

14

15 December 17, 2014

16 10:02 a.m.

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19 B E F O R E :

20 HON STUART M. BERNSTEIN

21 U.S. BANKRUPTCY JUDGE

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1 Motion to Dismiss

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3 Motion for Entry of Order Pursuant to Section 105(a) of the
4 Bankruptcy Code and Rules 2002 and 9019 of the Federal Rules
5 of Bankruptcy Procedure Approving a Settlement Agreement by
6 and between the Trustee, on the one hand, and Primeo Fund
7 and Herald Fund SPC on the other hand

8

9 Motion for Entry of Order Pursuant to Section 105(a) of the
10 Bankruptcy Code and Rules 2002 and 9019 of the Federal Rules
11 of Bankruptcy Procedure Approving a Settlement Agreement by
12 and between the Trustee and Senator Fund SPC

13

14 Motion for Entry of Order Pursuant to Section 105(a) of the
15 Bankruptcy Code and Rules 2002 and 9019 of the Federal Rules
16 of Bankruptcy Procedure Approving a Settlement by and
17 between the Trustee and Westport National Bank, a Division
18 of Connecticut Community Bank, N.A.

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20 Motion to Consolidate Adversary Proceedings

21

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23

24

25 Transcribed by: Sherri L. Breach

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18 OREN WARSHAVSKY

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1 P R O C E E D I N G S

2 THE CLERK: Please be seated.

3 THE COURT: Good morning.

4 Madoff. Anyone here on Madoff?

5 (Laughter)

6 MR. MURPHY: One or two, Your Honor.

7 THE COURT: Okay. Why don't we start with the
8 settlements.

9 MR. MURPHY: Fine, Your Honor.

10 (Pause)

11 MR. MURPHY: Good morning, Your Honor. How are
12 you?

13 THE COURT: Good morning.

14 MR. MURPHY: Good morning, Your Honor.

15 THE COURT: Good morning.

16 MR. MURPHY: Keith Murphy, Baker & Hostetler for
17 the trustee.

18 This motion, Your Honor, is pursuant to Bankruptcy
19 Rule 9019 and Section 105(a) of the Bankruptcy Code for
20 approval of a settlement between the trustee and Westport
21 National Bank.

22 The trustee brought an avoidance action to recover
23 transfers from BLMIS to Westport's account. The account was
24 an omnibus account for the benefit of Westport's clients,
25 200 of the bank's clients. The clients were directed to the

1 bank by the other defendants in this case, Robert Silverman
2 and his PCSS Services Companies.

3 The banks clients were retirees and pensioners and
4 they periodically redeemed money through the Westport
5 account to cover living and retirement expenses. The
6 clients' redemptions through the Westport account, along
7 with payments of fees to Westport and the other providers,
8 basically exceeded all their subscriptions. So this pattern
9 continued throughout the life of the account.

10 Based on BLMIS's books and records, Westport
11 withdrew a total of \$28.2 million during the six-year
12 period. From that amount Westport and the other defendants
13 in the case received fees. With respect to Westport, those
14 fees were approximately 2.1 million in the six-year period
15 and \$660,000 in the two-year period.

16 During the course of the case and settlement
17 discussions the trustee conducted due diligence with respect
18 to Westport's investment in BLMIS, the Westport account
19 itself, and the dealings between Westport, bank clients and
20 Mr. Silverman and his companies. We reviewed transaction
21 histories, correspondence, third party documents, and other
22 records and documents available to the trustee.

23 Westport, along the course, scooted liability.
24 They argued that they didn't provide any investment advice
25 or guidance in connection with their clients' decisions to

1 invest with BLMIS. They also had a custodial agreement with
2 its clients which acknowledged that the bank had no
3 authority or ability to direct or influence or oversee in
4 any manner the investments made by BLMIS. The agreement
5 also provided that they were acting solely in a ministerial
6 capacity. And as further evidence of that they indicated
7 that their fee, their custodial fee was only six-tenths of
8 one percent for this task.

9 The parties engaged Peter Borowitz (ph) as a
10 mediator and the settlement negotiations took place, and as
11 a result of those negotiations and the trustee's
12 investigation and, frankly, after thorough consideration of
13 the uncertainty, the delay, the cost and risks associated
14 with the adversary proceeding the parties determined to
15 settle the matter.

16 The terms are set forth on Exhibit A to the
17 motion, Your Honor, which is the settlement agreement. A
18 couple of the more salient points, the settlement calls for
19 a payment of 1.3 million to the trustee within 15 days after
20 entry of an order by the Court approving the settlement. It
21 will also result in the withdrawal of the claim that was
22 filed by Westport. It includes mutual releases and
23 ultimately a dismissal of the adversary proceeding.

24 The trustee submits that the settlement falls well
25 within the range of reasonableness for a settlement. The

1 agreement actually will resolve all claims raised by the
2 trustee against Westport and avoid certainly what would be a
3 lengthy and contentious litigation regarding the trustee's
4 avoidance claims, Your Honor.

5 The settlement will bring significant funds into
6 the estate and will benefit the customer property fund and,
7 furthermore, it would also complete this chapter of the
8 Madoff story. After the settlement with Westport the other
9 defendants in the case, during the course of the case,
10 sought bankruptcy relief and obtained it. And the trustee
11 was able to obtain partial satisfaction through an allowed
12 claim in Mr. Silverman's bankruptcy which was paid -- it was
13 a modest cash payment along with a lien on real property.

14 This closure of this case would result in the
15 adversary proceeding being fully resolved, and I note that
16 there were no objections to the settlement, Your Honor.

17 THE COURT: Is there anyone that wants to be heard
18 in connection with the --

19 MR. BELL: Yes, Your Honor.

20 THE COURT: -- application --

21 MR. BELL: Kevin Bell from Securities Investment
22 Protection Corporation. SiPC has been involved with Baker,
23 the trustee's counsel. SiPC supports this settlement which
24 results not only in a payment, but clarity on Westport's
25 claim in the customer proceeding. The current payment will

1 result in a payment to allowed customer claims of the
2 results of the trustee's recovery once there is an entry of
3 the order.

4 THE COURT: Okay.

5 MR. BELL: Thank you, Your Honor.

6 THE COURT: I'll approve the settlement. It's
7 certainly well within the lowest point in the range of
8 reasonableness. I guess the question is whether the bank
9 was a customer in that winter and, if so, how much it might
10 be liable to for the estate. But it appears that it served
11 in a ministerial capacity. And I'll note that the payment
12 is twice what they received within the two years.

13 So the application is approved.

14 MR. MURPHY: Thank you, Your Honor. We'll --

15 THE COURT: You can submit an order.

16 MR. MURPHY: We'll email an order. Thank you,
17 Your Honor.

18 THE COURT: Okay.

19 MR. BELL: Thank you, Your Honor.

20 THE COURT: Thank you.

21 (Pause)

22 THE COURT: Just --

23 MR. WARSHAVSKY: Good morning, Your Honor. Oren
24 Warshavsky of Baker Hostetler. I'm here first to talk about
25 the settlement with Herald and Primeo Funds. These are two

1 of what we called feeder funds that invested with BLMIS.

2 In the six years prior to the Madoff's
3 liquidation, Primeo withdrew \$139 million. Primeo was not a
4 customer at the time of BLMIS's insolvency. Instead, it
5 actually had withdrawn its money and put most of it into the
6 Herald Fund. In the six years prior to the liquidation the
7 Herald Fund withdrew \$567 million, Your Honor.

8 One of the issues that came up during this -- the
9 course of our settlement negotiations was how much to credit
10 to the withdrawal by JPMorgan. By way of background, I know
11 Your Honor presided over that agreement, but JPMorgan
12 withdrew significant money from the Herald Fund, 154
13 million. JPMorgan had paid back a lump sum to the trustee
14 for a variety of claims brought by the trustee.

15 The parties engaged -- also engaged Peter Borowitz
16 as it happens as a mediator and reached an agreement whereby
17 the trustee is giving Herald -- has credited to Herald Fund
18 approximately \$100 million out of the payment from JPMorgan.
19 Herald Fund will pay four -- to the trustee \$467 million and
20 Primeo Fund will pay to the trustee \$29 million. All of
21 that will be taken out of the credit given to Herald Fund
22 and -- with its customer claim.

23 And I -- I don't know if Your Honor has any other
24 questions, but the trustee is getting the full six-year
25 amount from Herald Fund, more than the two-year amount from

1 the Primeo Fund. There's no claim to the Primeo Fund. It's
2 a total of close to \$490 million, Your Honor.

3 THE COURT: Is the claim -- the net equity claim
4 of Herald what it would be if you just determined it under
5 the net equity of or the net investment method?

6 MR. WARSHAVSKY: No. We are -- it is -- it's what
7 it would be if we were crediting, but we are adding in the
8 \$467 million --

9 THE COURT: I -- I'm not saying that.

10 MR. WARSHAVSKY: Okay.

11 THE COURT: Before you start subtracting from it,
12 the net --

13 MR. WARSHAVSKY: Yes.

14 THE COURT: -- equity claim, is that the claim
15 that you were -- that would normally be under the --

16 MR. WARSHAVSKY: Yes, Your Honor.

17 THE COURT: -- net equity? All right. So they're
18 basically paying you the money and they're getting their net
19 equity claim?

20 MR. WARSHAVSKY: Correct, Your Honor.

21 THE COURT: All right.

22 MR. WARSHAVSKY: So --

23 THE COURT: Okay. Does anyone want to --

24 MR. WARSHAVSKY: -- that's all.

25 THE COURT: -- be heard?

1 MR. BELL: SiPC was informed by the trustee and
2 participated in the mediation. We support the settlement
3 which not only results in a payment to the trustee in a
4 significant sum of money, but it provides clarity as the
5 Court has noted on a very significant dollar amount in the
6 net equity claim of Herald and upon the Court's approval
7 will -- will result in the allowed claims jumping by 1.6
8 million -- billion dollars which, when you look at the \$20
9 billion world of net equity is a significant amount.

10 And the -- this payment will result soon in a
11 payment of recovery amounts that will allow other allowed
12 customer claims once the Court enters an order. We would
13 suggest that such an entry of an order is an appropriate
14 action by the Court.

15 THE COURT: All right. I'll approve this
16 settlement that sounds to me like what the -- putting aside
17 the question of the credit from the JPMorgan payment that
18 they're basically repaying more than they got within two
19 years and they're getting -- at least Herald is getting the
20 net equity claim that it would be entitled to and the 502(h)
21 claim that it would be entitled to.

22 So -- and given that SiPC supports it, it's a
23 result of mediation, it certainly falls well within the
24 lowest range -- well within the lowest point in the range of
25 reasonableness.

1 So it's approved and you can submit an order.

2 Thank you.

3 MR. WARSHAVSKY: Thank you, Your Honor.

4 (Pause)

5 MR. MURPHY: Your Honor, the final settlement I'll
6 talk to you about is with the Senator Fund and I should
7 start, Your Honor, by noting that we were here about nine
8 months ago with a --

9 THE COURT: I remember that.

10 MR. MURPHY: -- motion to go to mediation and I --

11 THE COURT: And you didn't want to go to
12 mediation.

13 MR. MURPHY: -- was vociferously -- that's right.

14 THE COURT: And what do you know, you settlement
15 -- you settled it.

16 (Laughter)

17 MR. MURPHY: Well, I guess that shows why you're
18 the one wearing the black robes and it was a good decision.

19 (Laughter)

20 THE COURT: It just explains why you had to go to
21 mediation.

22 MR. MURPHY: That's right.

23 THE COURT: Well, I'm glad it worked out.

24 MR. MURPHY: And once again, Your Honor, this is a
25 -- one of the parties to that mediation is the Senator Fund.

1 The Senator Fund had life to date withdrawals. It's also
2 the same as the two-year withdrawals of \$95 million.

3 Senator Fund is -- has agreed to pay that money
4 back in out of its net equity claim. It will be credited
5 for 90 percent of the money that it is putting in. The
6 Senator Fund also has agreed to share with the trustee on a
7 50/50 basis its claims against its service provider, HSBC.

8 Once again, Your Honor, we think, given that it's
9 100 percent of the trustee's two-year claim and in return
10 we're allowing most of the net equity claim we believe this
11 to fall well within the zone of reasonableness, and I'm here
12 to answer any questions Your Honor might have. Otherwise
13 I'll defer.

14 THE COURT: Is there anyone else who wants to be
15 heard?

16 MR. BELL: Again, SiPC participated. Kevin Bell
17 on behalf of SiPC.

18 SiPC participated in the mediation. It finds that
19 it supports the settlement which results in the recovery to
20 the trustee with -- for the benefit of all the other
21 remaining unpaid net equity claimholders of allowed claims,
22 and it provides clarity on Senator's net equity claim which
23 will increase the allowed amount that has been paid to
24 customers once this Court enters the order.

25 THE COURT: I'll approve this settlement. Senator

1 is paying 100 percent of the two-year transfers and getting
2 less than 100 percent of its net equity claim in exchange
3 and there seems to be a kicker at the end, which may or not
4 -- may not bring more money into the estate.

5 So that settlement is approved. You can submit an
6 order.

7 MR. MURPHY: Thank you, Your Honor.

8 THE COURT: Let's do the consolidation motion
9 next.

10 (Pause)

11 MS. HARRIS: Good morning, Your Honor. Marcy
12 Harris on behalf of the Picower parties, and with me Michael
13 Kwon of Schulte, Roth & Zabel --

14 THE COURT: How do you do?

15 MR. KWON: Morning, Your Honor.

16 MS. HARRIS: -- and Jennifer Opheim.

17 MR. HUYNH: Good morning, Your Honor. Hanh Huynh,
18 Herrick Feinstein, on behalf of the Goldman defendants.

19 THE COURT: Okay.

20 MS. HARRIS: Your Honor, the Picower parties filed
21 an enforcement action to enforce the permanent injunction
22 which bars the Goldman plaintiffs from litigating the claims
23 in what we call Goldman 3, their third attempt to file a
24 non-derivative claim against the Picower parties.

25 At the same time, in mid-November the trustees

1 filed an enforcement motion and course of action as well.
2 We consolidated -- we sought to consolidate the two actions
3 together at the time of filing. The trustee consented to
4 that consolidation so that the two actions which raised the
5 same legal issues and concern the same facts could go
6 forward together in an efficient matter.

7 We reached out at that time to the Goldman counsel
8 to ask whether they, too, would agree to consolidate and
9 they wanted to wait and see the papers before they reached a
10 determination.

11 We now ask again for the Court to consolidate the
12 two actions and also to stay them in this court because in
13 response to the trustee's filing the Goldmans have sought to
14 withdraw the -- made a motion to withdraw the reference to
15 the District Court. That motion will be heard by Judge
16 Kotel (ph).

17 THE COURT: Is there a date for that?

18 MS. HARRIS: I don't believe there is.

19 MR. HUYNH: There's no date, Your Honor.

20 THE COURT: Okay.

21 MS. HARRIS: And in addition the deadline for
22 responding to the enforcement actions in this court was
23 earlier this week. The Goldmans responded to the trustees
24 and not to the Picower parties substantively. Instead, they
25 --

1 THE COURT: Did they put it in the same brief?

2 MS. HARRIS: No. They put in a very short, but a
3 brief brief that is basically a preview of coming
4 attractions. They plan to file a motion to dismiss next
5 week. They have another motion for summary judgment that
6 they plan to make thereafter. And this would set the two
7 actions on very different schedules.

8 THE COURT: Okay.

9 MS. HARRIS: Consolidation is appropriate here in
10 the Court's discretion where the legal issues are the same
11 and the factual issues are similar or the same. And here
12 both the trustee's action and the Picower action seek the
13 same thing, to have the Court determine whether the claims
14 in Goldman 3 that were claimed are derivative of the
15 trustee's claims or not. The same allegation -- it's the
16 same complaint that's being addressed, and the facts in that
17 complaint would have to be addressed by both the parties,
18 the trustee and the Picower parties.

19 It makes no sense to have the two cases heard
20 separately by this Court or by two different courts. That
21 would be inefficient. It would be burdensome to the courts
22 and the parties, costly, and would raise the risk of
23 inconsistent outcomes.

24 So we are asking for consolidation of the two
25 actions. Stay the proceedings here until there is a

1 resolution, a determination on the withdrawal motion, and
2 then if the -- if the trustee's action is withdrawn post-
3 consolidation, the two actions can go together in District
4 Court.

5 If the motion is denied, I would ask for a case
6 management conference here so that there can be coordination
7 and the actions can be -- proceed here together on the same
8 schedule.

9 And I would point out also that the Goldmans
10 previously have recognized the benefits of consolidation
11 with respect to challenges to the permanent injunction
12 because in related actions in Florida between the Goldman
13 parties and related parties, Fox Marshall, the Goldmans
14 sought to consolidate their action down in Florida with the
15 Fox Marshall action because both actions required
16 determination whether the permanent injunction barred an
17 earlier version of their complaints and the same facts were
18 at issue. And in the interest of judicial economy and
19 efficiency they agreed it made sense to hear the actions
20 together.

21 So for the identical reasons we seek consolidation
22 of the Goldman 3 -- of the two enforcement actions with
23 respect to Goldman 3 claims.

24 THE COURT: Thank you.

25 MS. HARRIS: Thank you.

1 MR. HUYNH: Good morning, Your Honor.

2 THE COURT: Good morning.

3 MR. HUYNH: First, as a preliminary matter, with
4 respect to the suggestion that there be a stay pending the
5 decision on the motion to withdraw the reference, I don't
6 think that's before the Court today. It's just the
7 consolidation. We absolutely do not agree to that.

8 THE COURT: Well, as a --

9 MS. HARRIS: It's --

10 THE COURT: -- practical matter, though, if Judge
11 Kotel were going to decide the same issue I wouldn't be
12 spending time deciding it. That doesn't seem to be --

13 MR. HUYNH: That's --

14 THE COURT: -- a good use of judicial resources.

15 MR. HUYNH: That's correct, Your Honor. But we
16 don't know when that's going to happen. It goes to our only
17 concern in this case which is that there be no delay with
18 respect to a disposition of the trustee's preliminary
19 injunction motion. And the reason we seek that is because
20 contrary to what counsel is saying here, the relief is not
21 the same. They're seeking an entirely different relief, one
22 which would bar the Goldman plaintiffs from pursuing any
23 future litigation against any of those parties arising from
24 the Madoff Ponzi scheme.

25 THE COURT: Well, that's like asking -- seeking a

1 denial of leave to re-plead. That's all.

2 MR. HUYNH: It's different relief, Your Honor, and
3 that's -- and the basis for their relief also is the subject
4 to a motion to dismiss which we don't believe the trustee's
5 complaint is. So that's -- because they -- we -- in our
6 view they lack standing. And Securities' counsel is better
7 able to articulate that --

8 THE COURT: Okay.

9 MR. HUYNH: -- and that brief is forthcoming on
10 the 22nd, Your Honor. So for that reason we think it
11 actually -- the judicial economy would be better served if
12 we kept this adversary proceeding here until we could decide
13 whether there is an adversary proceeding at all with respect
14 to the standing issue.

15 THE COURT: What's the basis of the motion to
16 dismiss?

17 MR. HUYNH: The lack of standing, Your Honor.
18 That the --

19 THE COURT: Why do they lack standing?

20 MR. HUYNH: That the -- in our view the Picower
21 defendants are not the direct beneficiaries of the order
22 entered --

23 THE COURT: Can I ask you a question? I looked at
24 the settlement agreement last night and the trustee agreed
25 to use its best efforts to get the Bankruptcy Court to

1 approve this settlement and to include an injunction that
2 protected the Picower parties. Do you think that was at the
3 trustee's insistence or the Picower parties' insistence?

4 MR. HUYNH: I wasn't party to negotiations, but --

5 THE COURT: What do you think?

6 MR. HUYNH: -- I think it would be --

7 THE COURT: Well, I wasn't either, but what do you
8 think?

9 MR. HUYNH: -- at the Picowers' -- I think --

10 THE COURT: All right. So --

11 MR. HUYNH: -- it would be at the Picowers'
12 insistence.

13 THE COURT: So you think that was intended to
14 benefit the Picowers?

15 MR. HUYNH: I do believe it was intended to
16 benefit the Picowers, but the order that entered approving
17 the settlement agreement was for the benefit of the
18 plaintiffs' estates and --

19 THE COURT: No, it wasn't.

20 MR. HUYNH: -- not for the Picower defendants.

21 THE COURT: No. That's not true. I believe it's
22 paragraph 8 -- I'm sorry, the third -- the -- everybody is
23 permanently enjoined from asserting any claim against the
24 Picower accounts and the Picower releasees. So they're
25 clearly covered by the order.

1 But let's -- let's move off this because I don't
2 have a motion to dismiss for lack of standing. What's the
3 problem with consolidating the actions and just making the
4 motion either before me or Judge Kotel, depending on what
5 the result of the motion to withdraw is?

6 MR. HUYNH: We have no problem with that as long
7 as it doesn't disrupt the current schedule we have with
8 respect to the trustee's preliminary motion. That's been
9 briefed. We're only waiting for --

10 THE COURT: The trustee's -- isn't that the one
11 that you have moved to withdraw the reference on?

12 MR. HUYNH: That's correct, Your Honor.

13 THE COURT: So you've delayed it.

14 MR. HUYNH: But --

15 THE COURT: If you didn't move -- make that
16 motion, I would have decided it sooner.

17 MR. HUYNH: That motion's been made. We will
18 consider withdrawing that motion to withdraw the reference.
19 The issue there is, as we said, if the motion to withdraw
20 the reference had been disposed of quickly, then we would be
21 in front of Judge Kotel. We just don't want to wait because
22 in the event that that motion sits there in the District
23 Court for some time, we've effectively undermined our intent
24 when we -- when the parties all agreed back in November or
25 back in September to -- that the Goldman plaintiffs would,

1 without motion practice in the Southern District of Florida,
2 allow the -- that action to be stayed because we thought
3 there would be a quick, efficient disposition of the trustee
4 motion here in the Bankruptcy Court.

5 THE COURT: Well, there might have been, but you
6 made a motion to withdraw the reference.

7 MR. HUYNH: We -- we will -- we'll consider
8 withdrawing that motion, Your Honor.

9 THE COURT: All right.

10 MR. HUYNH: Hindsight, Your Honor.

11 THE COURT: Okay. I'm going to grant the motion
12 to consolidate the two actions. They are -- both actions
13 involve the same -- same issue involving the same Goldman 3
14 complaint and the same injunction entered by the Bankruptcy
15 Court. I know that Mr. Picard's action also implicates the
16 automatic stay, but I didn't even have to reach the
17 automatic stay and I think it's really co-extensive with the
18 settlement injunction which bars derivative claims.

19 And those two issues have to be decided before you
20 get to the issue of whether a permanent injunction or a non-
21 permanent injunction is appropriate, or any injunction is
22 appropriate for that matter.

23 So there are certainly common issues of law. Both
24 courts are going to have to sit down and compare the
25 allegations of the Goldman 3 complaint to the language in

1 the permanent injunction as well as the prior decisions that
2 have interpreted it.

3 And for that reason I'm going to grant the motion.
4 You can submit an order. Thank you.

5 MR. HUYNH: Thank you, Your Honor.

6 THE COURT: Thank you.

7 MS. HARRIS: Thank you.

8 THE COURT: I'll hear the Kingate motion to
9 dismiss now.

10 (Pause)

11 THE COURT: Go ahead.

12 MR. LOIGMAN: Good morning, Your Honor. Robert
13 Loigman of Quinn Emanuel for the joint liquidators of the
14 Kingate Euro Fund and the Kingate Global Fund.

15 Before we get to the trustee's claims this
16 morning, Your Honor, I would like to start by reminding the
17 Court who the Kingate funds are. And the Kingate funds are
18 net losers and they have been net losers since the day that
19 they started investing with Madoff 14 years before the
20 collapse of BLMIS. Collectively, the two funds lost \$800
21 million. They could have withdrawn this amount and more as
22 scores of other investors did, but they didn't.

23 The Kingate funds invested solely with Madoff and,
24 as a result, are insolvent today. The funds are now subject
25 to formal insolvency proceedings and are being administered

1 by court-appointed liquidators, the liquidators that I
2 represent here today for the benefit of their innocent
3 investors. This is similar to Mr. Picard administering
4 BLMIS for the benefit of Madoff customers.

5 THE COURT: I thought those customers of the funds
6 have claims against the funds or the funds' management for
7 failure to do due diligence and things -- things like that?

8 MR. LOIGMAN: Absolutely, Your Honor. And I'll
9 come to that in due course.

10 THE COURT: I'm not sure it's relevant.

11 MR. LOIGMAN: All right.

12 THE COURT: I'm just --

13 MR. LOIGMAN: I think it is relevant. In fact, I
14 think it's helpful to our argument here today and I'll set
15 forth why.

16 But that goes to what the Kingate funds are made
17 up of, which is innocent investors. And these investors
18 pooled their money and through the Kingate funds invested in
19 Madoff and now they are victims of Madoff as recognized, for
20 example, by the Department of Justice.

21 I'll also remind the Court what the Kingate funds
22 are not and what the trustee does not allege them to be.

23 First of all, they're not parties that were
24 intricately involved in carrying out Madoff's fraud. You
25 saw allegations of that in the Comad (ph) action in

1 contrast.

2 The Kingate funds and their managers, okay, are
3 not close friends with or confidants of Madoff as was the
4 case with Ezra Merkin (ph).

5 And the Kingate funds are not parties that
6 received information from Madoff that was any different from
7 or any more extensive than what all other BLMIS investors
8 received.

9 And, finally, the Kingate funds -- and I'll
10 explain this in more detail a little bit later Your Honor --
11 is they're not the same as their investment managers. The
12 funds are pooled money of individual innocent investors.
13 And as Your Honor pointed out, in fact they are suing their
14 managers for return of management fees.

15 THE COURT: Okay. But that was true in Merkin
16 also and it's true in all of these fund -- you know, these
17 cases of feeder funds.

18 MR. LOIGMAN: Your Honor, I can jump ahead in my
19 argument to that point because you asked about it.

20 What we'll be talking about today and all of the
21 allegations in the complaint are really allegations about
22 the investment managers, not allegations about the funds.

23 THE COURT: Well, the funds are entities that --
24 they can only acquire knowledge through someone. And are
25 you saying that even if the people that the trustee says

1 knew were willfully blinded themselves to the Ponzi scheme
2 actually knew or willfully blinded themselves that that's
3 not attributed to the fund?

4 MR. LOIGMAN: I am saying that, Your Honor.

5 THE COURT: Were they agents of these people?

6 MR. LOIGMAN: They were agents with respect to
7 investing their principal. And I can explain why, Your
8 Honor, their knowledge, if they had knowledge -- and we
9 challenge that obviously -- would not be imputed to the
10 funds.

11 If the managers knew, as the trustee is now
12 arguing, that Madoff was a fraud or if they were willfully
13 blind to that fact, then the only reason, the only reason
14 why they would direct the Kingate funds to invest in Madoff
15 would be to generate management fees for themselves. In
16 other words --

17 THE COURT: But there's also a benefit to the fund
18 because the funds stay alive and the aura of profitability
19 attracts additional investors. Isn't that what the case law
20 says?

21 MR. LOIGMAN: Actually, Your Honor, there is no
22 benefit to the funds at all. By staying alive, by
23 continuing their corporate existence, there's no benefit to
24 the funds. I realize that in the Merkin case, for example,
25 Your Honor held that Merkin's conduct would be imputed to

1 the funds. But this case is very different than that for an
2 important reason.

3 In Merkin, the funds at issue invested not only in
4 BLMIS, but in other legitimate investments. So as a result
5 when they showed positive returns from Madoff, they got
6 additional investors, new investors. They brought in more
7 money, and they made real and legitimate returns from these
8 other investments.

9 As Your Honor pointed out in the Merkin decision,
10 Gabriel and Arial invested between 23 and 25 percent in
11 BLMIS and the third fund, Ascot, had at times up to nine
12 percent of assets invested elsewhere. And as Your Honor
13 explained in that decision, because of these legitimate
14 investments elsewhere the Court concluded that there were
15 sufficient allegations that the fund benefited from
16 investments with BLMIS prior to discovery of Madoff's fraud.

17 THE COURT: But there was another part of the
18 decision that talked about the benefits based on the aura of
19 profitability.

20 MR. LOIGMAN: Okay. But the aura of
21 profitability, Your Honor, is not a benefit to the funds.
22 The -- and I'll point Your Honor's attention to what I think
23 is the leading case in New York on imputation, which is the
24 Kershner v. KPMG case from the New York Court of Appeals.

25 And what the Kershner case makes clear is that you

1 need to distinguish between what is called conduct that
2 defrauds the corporation and conduct that defrauds others
3 for the corporation's benefit. And think about what
4 happened in that case.

5 In that case the Refco insiders cooked the books
6 and the reason they did that was to raise more money from
7 Refco from outside lenders. That was real money, legitimate
8 money that came in to fund Refco's brokerage operations and
9 other things they did and also so that they could sell their
10 stock at inflated prices to third parties.

11 And as the District Court in Refco held, and this
12 was language that was repeated by the New York Court of
13 Appeals, under the trustee's allegations in that case the
14 Refco insiders stole for Refco, not from it.

15 But exactly what's happening here is that if the
16 managers -- and, again, that's a big if, right, if the
17 managers were willfully blind to the fraud or knew about the
18 fraud of Madoff, then they are stealing money from the
19 Kingate funds themselves. The only -- the Kingate funds
20 don't benefit. And the trustee recognizes this in the
21 complaint.

22 The Kingate funds were the ones that paid the
23 management fees to their managers. By continuing their
24 corporate existence, more money coming in, it doesn't
25 increase the NID of the funds in any way. It doesn't

1 increase the amount that they have available to distribute
2 to their investors. Merely continuing the corporate
3 existence doesn't benefit the funds.

4 Maybe I can give Your Honor an example that might
5 drive this home a little bit more clearly.

6 Assume that you have three different investors,
7 okay. Investor A hands his money to Madoff -- hands his
8 money directly to Madoff and says, I'm giving this to you to
9 invest in your discretion at BLMIS. This is what the
10 trustee has termed a direct investor.

11 That investor today, of course, has a claim
12 against BLMIS. The trustee doesn't impute Madoff's
13 knowledge to that investor even though the investor, the
14 customer gave money to --

15 THE COURT: Impute Madoff's knowledge?

16 MR. LOIGMAN: Exactly.

17 THE COURT: Why would -- I don't think the
18 trustee's arguing that he's imputing Madoff's knowledge to
19 the agents of the funds. He's arguing that the agents of
20 the funds acquired knowledge and that's imputed to the
21 funds.

22 MR. LOIGMAN: Exactly, Your Honor.

23 THE COURT: Right.

24 MR. LOIGMAN: And he's not arguing that if I give
25 my money to Madoff --

1 THE COURT: So why --

2 MR. LOIGMAN: -- for Madoff to manage --

3 THE COURT: -- why are you telling me this if
4 nobody's arguing it?

5 MR. LOIGMAN: I'm telling you this, Your Honor,
6 because in our case the Kingate funds gave their money to
7 investment managers to be managed for them, to be invested
8 at the manager's discretion. And now the trustee is
9 alleging that those managers knew or willfully blinded
10 themselves to the fraud of Madoff. And then he's asking
11 that those managers, their knowledge be imputed to the funds
12 that gave them their money to manage.

13 This is no different than giving your money to the
14 --

15 THE COURT: But the investors in the funds gave
16 the funds the money, but the investors are not the customers
17 here or the transferees.

18 MR. LOIGMAN: No.

19 THE COURT: They may be subsequent transferees and
20 that's a different issue.

21 MR. LOIGMAN: No. The funds are the customers. I
22 recognize that, Your Honor. But the funds gave their money
23 to the managers. The funds and the manager -- the managers
24 are not the funds themselves. The --

25 THE COURT: No.

1 MR. LOIGMAN: -- funds have a contractual
2 relationship with the managers. They give the managers the
3 money to manage on behalf of the funds for the benefit of
4 the funds. The same way that if I were an individual
5 customer and I went to a broker, say JPMorgan, and gave them
6 my money to manage, if they managed that money by investing
7 it in BLMIS, I still have a claim against BLMIS whether that
8 broker knew or not of fraud at Madoff. And I still have my
9 -- a claim against BLMIS even if I handed my money directly
10 to Madoff, the admitted fraudster --

11 THE COURT: But you have different kinds of
12 claims. You may have a general unsecured claim based on a
13 Madoff fraud of the other claim and the victim's fund, but
14 you wouldn't have the customer or BLMIS --

15 MR. LOIGMAN: Actually, Your Honor, it's the same
16 claim. In each one of these instances I'm talking about a
17 customer of BLMIS. The person who hands his money directly
18 to Madoff is a customer of BLMIS.

19 THE COURT: Right.

20 MR. LOIGMAN: The person who goes to the broker,
21 gives his money to the broker and says, invest my money and
22 the broker takes that person's money and invests it in
23 BLMIS, that person is a customer --

24 THE COURT: Assuming there's an account in that
25 person's name.

1 MR. LOIGMAN: Right. And the Kingate funds,
2 which did have an account at BLMIS in their names, they are
3 a customer of BLMIS.

4 THE COURT: Right.

5 MR. LOIGMAN: They gave their money to the manager
6 to be managed for their benefit. And the manager, if they
7 knew about the fraud, wasn't managing it for their benefit
8 at all. It was doing it solely for the purpose of getting
9 increased management fees from the funds. The funds are
10 suing the managers for those fees.

11 THE COURT: I have your argument on the adverse
12 interest exception. You can -- why don't you move on to
13 something else?

14 MR. LOIGMAN: Okay.

15 Your Honor, I would like to turn back then to the
16 trustee's first set of claims. These are the claims for
17 six-year fraudulent transfer under New York State law as
18 well as the preference and constructive fraudulent transfer
19 claims under the Bankruptcy Code. These are in Counts I,
20 III, IV, V, VI, VII and VIII of the fourth amended
21 complaint.

22 And these claims all fail because they are barred
23 by the safe harbor in Section 546(e). Just last week, as
24 Your Honor knows, the Second Circuit affirmed Judge Rakoff's
25 holding that Section 546(e) applies in this SIPA case and

1 the only way to circumvent application of 546(e) is to plead
2 with particularity facts demonstrating that the Kingate
3 funds actually knew that Madoff was not trading securities.

4 Now Judge Rakoff made this standard clear in the
5 Comad decision which is law of this case because this
6 adversary proceeding was one of the actions that was
7 consolidated and withdrawn by Judge Rakoff for adjudication
8 of the 546(e) issue.

9 As Judge Rakoff said, the trustee must show at a
10 minimum that the transferee had actual knowledge that there
11 were no actual securities transactions being conducted.

12 Now that language could not be any clearer and the
13 trustee has not come even close to alleging that the Kingate
14 funds had actual knowledge that Madoff was not trading
15 securities. And we just went through, Your Honor, why we
16 believe the Kingate funds investment managers who were
17 acting adversely to the funds, their knowledge shouldn't be
18 imputed.

19 But for purposes of this discussion we'll assume
20 that their knowledge is imputed, which I think is incorrect.
21 The trustee's allegations don't show that they were aware he
22 wasn't trading securities. They show just the opposite;
23 that the managers believed Madoff was trading securities.

24 THE COURT: Are you talking about those front-
25 running allegations?

1 MR. LOIGMAN: Yeah. I mean, the first --

2 THE COURT: I mean, you can read that and say
3 that's what they're telling the people, but they didn't
4 necessarily believe it.

5 MR. LOIGMAN: That's not what the trustee alleges
6 in this complaint, Your Honor.

7 THE COURT: I read those allegations --

8 MR. LOIGMAN: But --

9 THE COURT: -- and he's alleging that this is what
10 they told the people --

11 MR. LOIGMAN: He --

12 THE COURT: -- or at least this is the answers
13 that they were --

14 MR. LOIGMAN: In the complaint, Your Honor, I
15 believe the trustee alleges that they believed that Madoff
16 was engaged in --

17 THE COURT: Where --

18 MR. LOIGMAN: -- the front running --

19 THE COURT: Where does it -- where do they allege
20 that?

21 MR. LOIGMAN: I believe it's in paragraph 140. I
22 guess you're right, Your Honor, that he says, he answered
23 the question.

24 THE COURT: Yeah.

25 MR. LOIGMAN: But he -- they have that in

1 paragraph 139. They have that in paragraph 140. They're
2 attributing Madoff's returns to what they call --

3 THE COURT: It certainly --

4 MR. LOIGMAN: -- front running.

5 THE COURT: It certainly implies -- one
6 implication is that they believe that Madoff was actually
7 engaged in securities transactions. Another implication,
8 though, is that this is what they're telling the people --

9 MR. LOIGMAN: I would --

10 THE COURT: -- or knew the opposite -- but they
11 knew the --

12 MR. LOIGMAN: I would point out two things about
13 that, Your Honor.

14 One is to the extent that they were saying he saw
15 the flows anyway, it doesn't -- it doesn't mean front
16 running anyway. That's not what --

17 THE COURT: I --

18 MR. LOIGMAN: -- front running is. Front running
19 is when a broker invests ahead of their customers. It
20 wouldn't be front running at all. If -- it does show, of
21 course, that they thought -- at least they were telling
22 people that Madoff was investing actual -- in actual
23 securities.

24 The other point with respect to that is this new
25 concept that comes up in the -- in their opposition brief

1 that that's just what they were telling people even though
2 they didn't believe that, that's not -- that's a new
3 argument. It's not alleged in the complaint anywhere. And,
4 most importantly, there's nothing that supports that. They
5 don't point to anything that supports that they didn't
6 believe that that was right what they were telling their
7 investors. They -- it's just an assumption in their brief.

8 Secondly, Your Honor, the trustee alleges that the
9 investment managers had a close relationship with Madoff.
10 It talks about hundreds of phone calls over the years.
11 That's about two per week during the time frame that they
12 alleged. They said they met with Madoff twice a year. They
13 say this -- that one of the managers once met Madoff and had
14 a tour of the 17th floor.

15 This all sounds like typical stuff, Your Honor,
16 for managers who invested nearly \$2 billion with Madoff.
17 It's a far cry from what was alleged with respect to Merkin
18 in terms of his relationship with Madoff.

19 And most importantly about that is that none of
20 these allegations say that anybody at BLMIS ever gave any
21 information to the Kingate funds managers that was any
22 different from what was being disseminated to all investors.
23 So they didn't have any more reason to believe that Madoff
24 was operating a Ponzi scheme.

25 THE COURT: Tell me -- tell me why Kingate funds

1 didn't willfully blind themselves in light of red flags
2 which they were obviously aware of since they came up with
3 these answers to questions which were the red flags
4 themselves.

5 MR. LOIGMAN: I'll -- let me start by answering
6 that question directly and then comparing it to the Merkin
7 decision where they held that they did allege willful
8 blindness.

9 First of all, the questions that they answered
10 from the investors in which they gave these answers to where
11 they explained why Madoff was achieving the returns that he
12 was achieving and why he did things, all of their answers
13 indicate the reasons why they believed Madoff was achieving
14 those returns.

15 So the mere fact -- and we'll use for example
16 because the most obvious is the fact that he achieved
17 consistent returns over the years is one of the principal
18 questions that was addressed there. They explained they
19 don't -- their belief of why he is receiving consistent
20 returns over the year.

21 The fact that he did that, one, was known to the
22 entire market, right? That's not something that's
23 particular to them that not everybody else in the world did.
24 And unless everybody in the world willfully blinded
25 themselves, that's not evidence of willful blindness.

1 In fact, the -- Your Honor, I apologize that I --
2 we didn't cite it, but it's because it's a decision that was
3 just released yesterday by the Second Circuit in the Elendow
4 Fund versus Ryan Investment Management.

5 THE COURT: How do you spell that?

6 MR. LOIGMAN: It's Elendow, E-L-E-N-D-O-W, and we
7 do have copies that we can hand up to the Court.

8 THE COURT: Okay.

9 MR. LOIGMAN: It is a summary order of the Second
10 Circuit and that was a class action or it was an action
11 against one of the managers of the Tremont Capital. And it
12 -- in that Judge -- okay. May I hand it up?

13 THE COURT: Thank you.

14 MR. LOIGMAN: Thank you.

15 (Pause)

16 MR. SHEEHAN: Can we make -- do I get one, Your
17 Honor?

18 THE COURT: I'm sure if you ask him -- I'm not
19 reading it now. But I'm sure if you ask him he'll give you
20 one or he can just run it off.

21 MR. LOIGMAN: Yeah. Your Honor, for the record,
22 we just handed one to Mr. Sheehan.

23 MR. SHEEHAN: Thank you.

24 MR. LOIGMAN: And, Your Honor, in this case what
25 the Second Circuit was acknowledging was that these kinds of

1 allegations they agreed with the District Court that they
2 don't fail -- they fail to plead (indiscernible) under the
3 securities law. They don't --

4 THE COURT: Let me ask you a question. What's
5 your difference between (indiscernible) under the securities
6 law and willful blindness for what we're talking about?

7 MR. LOIGMAN: Your Honor, I believe that conscious
8 disregard is the -- I'm sorry -- conscious recklessness,
9 okay, is --

10 THE COURT: Recklessness is different, I think,
11 from willful blindness.

12 MR. LOIGMAN: Then willful blindness. I think it
13 is and, in fact, Your Honor, I think willful blindness,
14 which some courts as you know have equated with actual
15 knowledge -- Judge Rakoff draws a distinction -- is a higher
16 --

17 THE COURT: Well, it's certainly not enough for an
18 aiding and abetting claim which is actual knowledge claim
19 and courts have drawn that distinction.

20 MR. LOIGMAN: That's right, although I believe in
21 the Beacon Hill case there was an equation of actual
22 knowledge with willful blindness. But for purposes of this
23 case it's clear that those things are different as Judge
24 Rakoff has held.

25 But the willful blindness standard is a very high

1 standard. Under willful blindness you have to show a
2 subjective belief, subjective belief on the part of the
3 defendant that they thought there was a high probability of
4 fraud. And then they have to take actions to avoid learning
5 of that fraud which they effectively already know about.

6 THE COURT: But what's the difference between that
7 and these securities cases? I know that there are a lot of
8 (indiscernible) securities cases involving Madoff --

9 MR. LOIGMAN: Right.

10 THE COURT: -- in District Court and the Circuit
11 Court. I'm just curious what you think the difference is in
12 the standard.

13 MR. LOIGMAN: You know, it's hard to articulate
14 the difference, Your Honor, because the language of the two
15 standards --

16 THE COURT: Right. But you're giving me a
17 securities fraud case.

18 MR. LOIGMAN: Right. But I think that the answer
19 is that the willful blindness is actually a more difficult
20 standard to fulfill because whereas recklessness is
21 sufficient in the securities cases, here we're not talking
22 about just recklessness. We're talking about the person
23 believed there was a high probability of fraud. That, I
24 think, goes beyond recklessness.

25 It -- the other thing that's interesting, of

1 course, about the Elendow decision is that it recognizes
2 that the fund itself was injured by Madoff's conduct.

3 But I'll give you an example, Your Honor, of what
4 willful blindness is and maybe that will answer the
5 question.

6 In the Merkin case, as Your Honor held, there was
7 evidence that he had a subjective belief -- again, it's a
8 subjective belief that he believed, okay, that there was a
9 high probability of fraud. And some of the evidence of that
10 that was relied upon in the Merkin case was that he himself
11 used the language of Ponzi schemes in describing Madoff
12 before Madoff collapsed. This was while Madoff was still up
13 and running, and that's when he said that Madoff scheme was
14 bigger than Ponzi and one day Charles Ponzi would lose out
15 because it would be called a Madoff scheme.

16 And there were allegations that one of the
17 portfolio managers told Merkin -- again, while BLMIS was up
18 and running -- that its trading was impossible and could be
19 a Ponzi scheme. And Merkin then spoke to this research
20 company and identified various different red flags and said
21 to them, because of these I would never go long in a big
22 way.

23 And then with all of this in front of him Merkin
24 says, I don't really care what Bernie Madoff is investing
25 in. I've made my peace with Bernie. And that, Your Honor,

1 is an example of exactly what willful blindness is. You
2 have all of these facts in front of you. You acknowledge --
3 you have a subjective belief that there's a high probability
4 of fraud and then you say, I don't care. I've made my peace
5 with Bernie. I'm a manager. I'll make whatever money I
6 make. I don't care what he's actually doing.

7 And that's what wholly absent in the Kingate funds
8 complaint. There's no allegation that the managers of the
9 Kingate funds -- and, again, we're focused on the managers -
10 - had a subjective belief that there was a high probability
11 of fraud.

12 So they may have looked at some of these same
13 facts out there that Merkin thought were red flags, things
14 like consistent returns that the entire market knew about;
15 things like using a small auditor that the entire market
16 knew about though they used PWC as their auditor; and they
17 didn't have a subjective belief in a high probability of
18 fraud. There's no allegation that supports that, Your
19 Honor.

20 And the other allegations in the complaint about
21 knowledge that go beyond these sort of generally widely
22 recognized things in the market talked about calculations,
23 determinations, analyses that the trustee has done post-
24 collapse with the assistance of Alex Partners that there was
25 no reason for the Kingate funds managers to engage in and,

1 importantly, no obligation of the Kingate funds to do those
2 types of analyses.

3 THE COURT: Well, I thought the -- part of the
4 allegations are if you looked at the statements that they
5 were doing you would see some of these things. I realize
6 that some of the things the trustee alleges would require
7 you to prepare statements to other sources of information.
8 But some of the allegations do go to the very documents they
9 were receiving from Madoff and they are looking at, but not
10 the average investor.

11 MR. LOIGMAN: Well, Your Honor, let me address
12 that -- both of those points.

13 In terms of looking right at the account
14 statements themselves, some of the things that they
15 purportedly should have discovered by looking at the account
16 statements were, for example, that a certain percentage of
17 the time Madoff was buying in the lower half of the downward
18 trading range and then some portion of the time --

19 THE COURT: Okay. Now that I admit --

20 MR. LOIGMAN: -- in the top range.

21 THE COURT: -- you would have to look at an
22 external source. But --

23 MR. LOIGMAN: Yeah.

24 THE COURT: -- other things, there were no ticker
25 symbols, I think, on the statements. The over the counter

1 trades didn't list counter parties when you got the count
2 confirmations.

3 MR. LOIGMAN: Right.

4 THE COURT: And -- and the option trade issue.

5 MR. LOIGMAN: Sure. And as to those types of
6 allegations, for example, they say trading outside the daily
7 price range, again, you would have to know what the daily
8 price range was.

9 They say that sometimes there was a negative
10 balance so there would have been margin trading that wasn't
11 -- the actual -- only way to determine that, Your Honor, is
12 if you look at these account statements there are hundreds
13 or thousands of trades on each account statement. It
14 doesn't show a running balance. They have a plus balance
15 and a minus balance. It's not like you look at the
16 statement and it says, you now have a negative balance.
17 You're trading on margin. You have to go through each one.
18 You have to determine how your balance is affected by each
19 one of the trades and then see where you're at. And that's
20 something that they didn't effectively do, needless to say,
21 because they didn't discover these things. And other people
22 in the market didn't do.

23 And in terms of like the ticker symbol, the QSIP
24 symbol that showed which exchange it was traded on, there's
25 no allegation that these guys knew that; that --

1 THE COURT: Well, isn't that something you would
2 know looking at these monthly statements? They were getting
3 monthly statements. They had hundreds of millions of
4 dollars invested.

5 MR. LOIGMAN: I -- but there's no reason to
6 believe that's something they would know. Again, that's
7 something that nobody in the entire market knew. People
8 much more sophisticated than even them didn't catch that
9 these were examples of any misconduct at BLMIS.

10 The trick with these types of allegations of red
11 flags is no matter how many red flags there are, I mean,
12 these managers, we can't assume that they would be able to
13 discern all of these things that nobody else discerned.
14 They made mistakes. Scotland Yard could make a mistake in
15 doing an investigation. You can't assume that they're going
16 to discover everything, and there's nothing alleged here
17 that shows that, one, they saw these things; two, they
18 appreciated them for what they were; and that, three, as a
19 result they formed a subjective belief of a high probability
20 of fraud at BLMIS.

21 And that's what's key is that if you have to
22 allege as the Second Circuit says in Salts (ph) v. Frontier,
23 not just that the red flags are out there, but that the
24 defendant was aware of these red flags. And then --

25 THE COURT: But those are security -- and I come

1 back to the same question. Those are securities fraud
2 cases, aren't they, where you have to show a strong
3 inference of (indiscernible), and I'm not sure that willful
4 blindness is the same standard. I'm asking, I'm not telling
5 you.

6 MR. LOIGMAN: And I think that's a very fair
7 question, Your Honor, and as I said before, and I do believe
8 it, I believe willful blindness is a higher standard because
9 the way that it's been articulated in the courts --

10 THE COURT: Than (indiscernible) in a securities
11 case?

12 MR. LOIGMAN: I think if you're going to compare
13 the two, I think --

14 THE COURT: Well, you have to have a --

15 MR. LOIGMAN: -- willful blindness --

16 THE COURT: -- a strong inference of
17 (indiscernible)?

18 MR. LOIGMAN: You have to have a strong inference
19 of (indiscernible). And with respect to willful blindness
20 you have to plead with particularity --

21 THE COURT: Well, that's true in a securities
22 fraud case also.

23 MR. LOIGMAN: That they had a subjective belief,
24 so now you're looking inside the mind of the defendant,
25 right, that there was a high probability of fraud.

1 And I think that is just astringent as any
2 securities standard that would apply, Your Honor. And
3 that's why some courts, not this Court and not Judge Rakoff
4 in these cases have equated that with actual knowledge.

5 So --

6 THE COURT: Well, it's obviously less than actual
7 knowledge.

8 MR. LOIGMAN: It is, but --

9 THE COURT: If it was actual knowledge we wouldn't
10 be having this discussion.

11 MR. LOIGMAN: Right. And I'm saying for purposes
12 of this case it is less than actual knowledge.

13 The other claim that I would really like to focus
14 Your Honor's attention on is the equitable subordination
15 claim because with respect to equitable subordination it's
16 an odd claim to assert against the party that has lost \$800
17 million by investing with BLMIS.

18 THE COURT: But it's only -- equitable
19 subordination is only asserted against people who have
20 claims.

21 MR. LOIGMAN: Well, exactly, Your Honor. So --

22 THE COURT: So there are -- so everybody has lost
23 money. Every defendant in an equitable subordination case
24 is a loser.

25 MR. LOIGMAN: Not really, Your Honor, because in

1 this case they have lost \$800 million and they have a claim.
2 If you apply it to -- the way that it's being applied in
3 this case is that it's actually punishing the Kingate funds,
4 right, for not withdrawing all of their money. All right.
5 If they had withdrawn all of their money, as plenty of other
6 investors did, as Your Honor points out, they would have no
7 claim. There would be no equitable subordination.

8 And then even if the trustee were to say, well,
9 they were bad guys and we should claw back everything that
10 they ever withdrew -- and for the reasons that we're
11 discussing I don't believe the trustee would have a valid
12 claim to that, all right -- then the funds would get a
13 corresponding 502(h) claim for anything that they paid back.
14 Even in that case they would be better off.

15 And there's nothing equitable about punishing a
16 customer for keeping its money invested in BLMIS. And that
17 is what equitable subordination would achieve here. It's
18 punishing them for keeping money invested. It's making them
19 worse off.

20 THE COURT: But they -- but -- or the customer in
21 this case is the Kingate funds, not the investors in
22 Kingate.

23 MR. LOIGMAN: The customer is the Kingate funds,
24 right, and the customer is the one that left their money in
25 the Kingate -- in BLMIS. They could have withdrawn it at

1 any time as plenty of other people did and they didn't.

2 And an important point with respect to that, Your
3 Honor, is that there are two elements, of course, to
4 equitable subordination. One is to show this egregious
5 conduct that's tantamount to fraud or misrepresentation.
6 And the second is to show harm to other customers.

7 With respect to the egregious misconduct element,
8 again, we've been through some of these points. They rely
9 on the same points at they did with respect to the
10 fraudulent transfer claims. Those allegations, I submit,
11 come nowhere close to alleging the type of egregious
12 misconduct that's tantamount to fraud because there's
13 nothing wrong with an investor withdrawing his own money.
14 And that -- plenty of investors withdrew all of their own
15 money --

16 THE COURT: If I were to conclude that the claim
17 adequately pleaded willful blindness, tell me why equitable
18 subordination might not be an alternative remedy, in other
19 words survive the motion to dismiss.

20 MR. LOIGMAN: Okay. Your Honor, there's a very
21 important reason because there are two elements of equitable
22 subordination. One is that the egregious misconduct, and if
23 we assume for now that willful blindness would be egregious
24 misconduct, even assuming that, the second element is that
25 there has to be harm to the other customers. And the

1 trustee hasn't alleged harm to BLMIS customers here. And
2 I'll walk you through that. There's --

3 THE COURT: What is the difference between this
4 and Merkin?

5 MR. LOIGMAN: Okay. Your Honor, there's two kinds
6 of claims, two kinds of harm, right, that the trustee is
7 alleging here and in Merkin, right?

8 First, he says that by investing in BLMIS the
9 Kingate funds gave Madoff this air of credibility so other
10 people invested with him, sort of propped it up. They kept
11 it going because they were putting money in.

12 That, I would submit, is backwards because under
13 that logic all the net losers are responsible for Madoff's
14 fraud. They're the ones who are funding the fraud and
15 continuing it, and they're actually the principal victims in
16 the fraud because they're net losers.

17 THE COURT: But all of the net -- all of the net
18 losers didn't engage in inequitable conduct according to the
19 trustee. They were just innocent -- basically innocent
20 victims.

21 MR. LOIGMAN: But that's the -- that's the --
22 that's talking about not the inequitable conduct side.
23 That's talking about --

24 THE COURT: Right.

25 MR. LOIGMAN: -- whether there's harm to other

1 customers.

2 THE COURT: But you're implying that all of the
3 net losers would be equitably subordinated and all I'm
4 saying is that that's only part of the equation.

5 MR. LOIGMAN: I'm just implying what the trustee
6 said, which is that they kept it alive, they kept the -- it
7 going by investing.

8 THE COURT: All right. But whatever the funds
9 withdrew, though, if they hadn't withdrawn it, that would
10 have been money available to the estate.

11 MR. LOIGMAN: Exactly. That's the second form of
12 harm that the trustee alleges and that's an important one
13 that I would like to address because, Your Honor, that only
14 looks at half the picture.

15 The Kingate funds invested nearly \$2 billion with
16 BLMIS and they withdrew only half of that amount. So as a
17 result of the Kingate funds investments there was \$800
18 million more in cash in BLMIS than there would have been if
19 they hadn't invested. And the trustee is divorcing the
20 deposits from the withdrawals and there's no basis for doing
21 that because --

22 THE COURT: But the trustee -- the trustee is
23 arguing that you -- that Kingate wasn't entitled to withdraw
24 anything and that every dollar it withdrew harmed the other
25 customers. That's essentially what the argument is.

1 MR. LOIGMAN: But, again, that's looking at half
2 the picture. The one thing that's beyond dispute -- I don't
3 think the trustee can dispute it. I don't think anybody can
4 dispute it, is that because the Kingate funds were
5 investors, when BLMIS stopped operating it should have had
6 \$800 million more in cash to distribute to everybody, not
7 less. The other customers were not harmed by the fact that
8 the Kingate funds invested in Madoff.

9 And if you say they were harmed by the fact that
10 they withdrew money, that's -- again, it's looking at only
11 half the picture. You have to look at what the Kingate
12 funds total conduct was. It was investing, infusing \$1.7
13 billion. The transfer of the money out is not the relevant
14 conduct. It's whether their investment hurt other
15 customers. And it clearly didn't hurt other customers. In
16 fact, the overall investment benefited other customers.

17 THE COURT: Why don't you wrap it up so I can hear
18 from --

19 MR. LOIGMAN: Sure. I'll wrap it up, Your Honor.
20 Let me just touch very, very briefly on the disallowance
21 claims that --

22 THE COURT: I've -- I've dealt with those already.

23 MR. LOIGMAN: Okay. Your Honor, then, if I could
24 ask for the ability to respond to anything.

25 THE COURT: Briefly.

1 MR. LOIGMAN: Thank you, Your Honor.

2 MR. SHEEHAN: Good morning, Your Honor.

3 THE COURT: Good morning.

4 MR. SHEEHAN: You would probably be very shocked
5 to hear that there's something I'm totally in agreement with
6 with Mr. Loigman, and that is that Ezra Merkin is --

7 THE COURT: What, that it's still morning?

8 MR. SHEEHAN: No. That Ezra Merkin was willfully
9 blind.

10 THE COURT: Well --

11 MR. SHEEHAN: All right.

12 THE COURT: -- I don't think his opinion counts.

13 (Laughter)

14 MR. SHEEHAN: You seemed to suggest that.

15 If Your Honor --

16 THE COURT: Why don't you move on to your next
17 argument?

18 MR. SHEEHAN: Yeah. Let me move on.

19 Let me actually, if I may, impose upon Your Honor
20 for a little bit of history here because I think it's
21 necessary, now that we have the benefit of Your Honor's
22 decision in Merkin, to look at this a little bit because I
23 think it does inform a good deal of how we should test the
24 elements of what are actual knowledge, which I think is a
25 really interesting question here not really dealt with,

1 although some would suggest otherwise, by Judge Rakoff
2 leaving it content to Your Honor.

3 And so I want to go back in time because -- and
4 I'll be very brief, I promise -- to go through this very,
5 very quickly how does it all start.

6 We start in July of 2011 with the Picard, you
7 know, withdrawal of the reference. And in that particular
8 instance, but what's most important is this, is that what he
9 is saying in there -- and I'm not going to quote the cases.
10 Your Honor can read them. But what's clear with what he's
11 saying is, is that unless we can show that these guys didn't
12 have a legitimate expectation -- key word here throughout
13 all of this is legitimate. They have to have a legitimate
14 expectation that, in fact, there was a fraud -- you know,
15 that there was a trading taking place. They were entitled
16 to believe in that. As a result of being entitled to
17 believe in that, they were entitled to have a safe harbor.
18 All of that is what gives them that protection.

19 And in that particular instance we're talking
20 about who he thought -- it's clear if you read all of it --
21 were unsophisticated people: A man on a baseball team, he
22 might have a lot of financial interest in real estate, but
23 they really weren't sophisticated.

24 And, by the way, securities law doesn't require
25 you to make inquiry with regard to your broker. It's just

1 not part of the game. That's all there.

2 So we then -- so he finds, therefore, that they
3 get the protection of safe harbor and now if we're going to
4 go after them at all we can only go for the two-year period,
5 and in that two-year period we've got to prove they're
6 willfully blind. And now that, on that we were sustained
7 with regard to them being willfully blind. They did not
8 only move to dismiss, they moved for summary judgment and
9 lost on both of them.

10 Why is that important? It's important because
11 when we fast-forward later, and I'll get to it in a moment
12 to Comad, you have to start realizing that that's only an
13 exemplar. It doesn't mean that you're not Comad. You're
14 not what we find here. You don't have actual knowledge.

15 THE COURT: I understand that.

16 MR. SHEEHAN: I know you do, Your Honor. But I
17 think our adversary sometimes suggests otherwise.

18 Here's the important part. So now we get to the
19 next part and we say to them, wait a minute. This is all
20 predicated, you -- you're saying that you take this account
21 opening documents and the other agreements there. You have
22 a legitimate expectation that there was trading and,
23 therefore, legitimately you're entitled to get the safe
24 harbor.

25 We say, well, wait a minute. What if you didn't

1 have a legitimate expectation? Should you be entitled to
2 the safe harbor? Should you be able to get that? And he
3 goes, huh, you've got something there. Let's brief that.
4 And we do an MTWR on that, and the next thing you know we
5 have an opinion from him with regard to whether or not you
6 can expect to get the protection of safe harbor.

7 And if you'll bear with me, Your Honor, I think
8 it's important to do this. I don't usually read very much
9 here, Your Honor, but I want to read at least from the
10 opinion, which is the opinion of the Court on the actual
11 knowledge. And this is where he starts at the beginning of
12 the case. And if you'll remember what Judge Rakoff was
13 doing in many of our cases where he would issue a bottom
14 line order, two pages, and then later on submit a one that
15 -- and this is the opinion that expands upon that bottom
16 line order.

17 And he says here in the bottom line order:

18 "Where the trustee has sought to recover transfers
19 made to a subsequent transferee, the avoidance of which
20 would otherwise be barred by Section 546(e)" -- oops. Am I
21 in the right opinion here? Nope. I got the wrong one.
22 I'll get it for you, Your Honor.

23 (Pause)

24 MR. SHEEHAN: No. I got the right one.

25 THE COURT: Which opinion are you reading from?

1 MR. SHEEHAN: I'm reading the Securities -- it's
2 -- the cite to this is -- well, in fact, I pulled out the
3 Westlaw cite. It's 213 Westlaw 1609154, Southern District
4 of New York. It's the third in the trilogy of the opinions,
5 the first one being Picard, second being Greif, and this
6 being the third one.

7 In the bottom line order -- let me -- let me read
8 both. It's just easier.

9 "Where the trustee has sought to avoid transfers
10 to an initial transferee, the avoidance of which would
11 otherwise be barred by Section 546(e), under the Court's
12 ruling in Katz and Greif, the original transferee will not
13 be able to prevail on a motion to dismiss some or all of the
14 trustee's avoidance action claims simply on the basis of
15 Section 546(e) safe harbor if the trustee has alleged that
16 the initial transferee had actual knowledge of the Madoff
17 fraud.

18 "Two: Where the trustee has sought to recover
19 transfers made to a subsequent transferee, the avoidance of
20 which would otherwise be barred by 546(e) to the initial
21 transferee, the subsequent transferee would not be able to
22 prevail on a motion to dismiss on some or all of the
23 trustee's avoidance claims simply on the basis of Section
24 546(e) safe harbor if the trustee has alleged that the
25 subsequent transferee has actual knowledge of Madoff's

1 securities fraud."

2 What does he not say there? He does not say there
3 are Ponzi schemes. He couldn't have meant that. It doesn't
4 make any sense. I realize he says that later in the
5 opinion. I realize he says -- he says a lot of things. He
6 says Madoff's fraud. He says absence of trading. He says
7 Ponzi scheme. They're all exemplars of what, no legitimate
8 expectation. It's exactly what that case stands for, not
9 that if you don't know it's a Ponzi scheme you get a free
10 ride.

11 Just as -- Your Honor, may I drift over to Judge
12 Schwain's (ph) courtroom for 30 seconds here? This is just
13 the other day. She's sentencing judge -- Ms. Crupe (ph) to
14 six years in prison --

15 THE COURT: Judge Schwain (ph).

16 MR. SHEEHAN: Judge Schwain. And she says: "As
17 the jury was instructed, knowledge that the operation was a
18 Ponzi scheme is not necessary for culpability." That means
19 you go to jail for six years. Well, we're not supposed to
20 be able to sue somebody because they say I didn't know it
21 was a Ponzi scheme. That is not what Judge Rakoff said.

22 THE COURT: Why --

23 MR. SHEEHAN: That would be illogical for him to
24 go there.

25 THE COURT: Tell me how you pled that the Kingate

1 funds had actual knowledge of the Ponzi scheme --

2 MR. SHEEHAN: Here, I'll give you --

3 THE COURT: -- or actual knowledge of the -- or
4 actual knowledge of whatever you think they would have had
5 to have actual knowledge of.

6 MR. SHEEHAN: All right. Can I add one thing? I
7 --

8 THE COURT: Yeah.

9 MR. SHEEHAN: -- let me answer it and then I'll --
10 it's better just to answer it.

11 Take, for example, the options trading and the
12 fact that they would look at that, all right. If you looked
13 at the options trading it wasn't that there -- that's part
14 of it and that's part of the story, et cetera, but the fact
15 is, is that there were options traded supposedly on their
16 statements for their accounts that exceeded the entire
17 options on the entire market for the day.

18 THE COURT: Wouldn't you have to -- you could only
19 figure that out by then going somewhere else to determine
20 what the option trading was.

21 MR. SHEEHAN: And why did they -- and you know
22 what that is? You know what makes it different? They're
23 not Katz. They're not Wilpon (ph). They're selling the
24 duty. They got paid \$370 million for what, to do nothing,
25 to sit on their hands. I don't think so. They got \$370

1 million because they said, you give me your money, other
2 people's money, not the Katz Wilpon money, other people's
3 money and I'm going to invest it for you.

4 And you know what I'm going to do, I'm going to
5 watch it. I'm going to use, as everybody else in the
6 industry does, we're going to watch it. That's what feeder
7 funds do. That's why you give your money to a feeder fund
8 because they're going to do net asset valuations. They're
9 going to use the sharp ratio, the check out volatility.
10 They all do it. They all do it every day.

11 THE COURT: But then aren't --

12 MR. SHEEHAN: They --

13 THE COURT: -- aren't -- are you really arguing
14 that their negligence performance of the duty to
15 investigate, which they owe to their own investors, not to
16 BLMIS, is grounds for founding that they were willfully
17 blind?

18 MR. SHEEHAN: Yes, because at the end of the day
19 --

20 THE COURT: But willful blindness and negligence
21 are different standards.

22 MR. SHEEHAN: I understand. But it's -- it's not
23 just negligence. They looked. They said they looked. They
24 saw it. They said they saw it. They -- there's documents
25 that say --

1 THE COURT: They said they saw what?

2 MR. SHEEHAN: They saw the -- they compared these
3 things. They looked at them.

4 THE COURT: Okay. So where is that pleading --

5 MR. SHEEHAN: I think they --

6 THE COURT: -- that they saw that the options
7 traded --

8 MR. SHEEHAN: The --

9 THE COURT: -- had exceeded the daily volume.

10 MR. SHEEHAN: Pardon?

11 UNIDENTIFIED SPEAKER: Account statements --

12 MR. SHEEHAN: Yeah. We have -- all right.

13 THE COURT: All right. They looked at the account
14 statements. I understand that.

15 MR. SHEEHAN: Right.

16 THE COURT: But where does it allege that they
17 looked at the account statements --

18 MR. SHEEHAN: Okay.

19 THE COURT: -- and they saw that the options
20 exceeded all of the -- the options trading exceeded all of
21 the options --

22 MR. SHEEHAN: Because if you look at it and you
23 compare it to something else that they should have, they
24 would have. All right. That's not --

25 THE COURT: When you say --

1 MR. SHEEHAN: -- just negligence here --

2 THE COURT: When you say should have and would
3 have, that starts to sound like a negligence standard.

4 MR. SHEEHAN: But here's the --

5 THE COURT: I'm having a lot of difficulty in my
6 own mind separating negligent inquiry from willful blindness
7 from actual knowledge. That's --

8 MR. SHEEHAN: So what were they supposed to do?
9 They did nothing. They just looked at the statement. They
10 got paid \$370 million. Your Honor's saying that's
11 negligence. No. What I'm saying is they looked. And, by
12 the way, we're at a motion to dismiss here. I've got a
13 plausible argument, not probable, plausible that these guys
14 got paid \$370 million. They got all these statements. They
15 went out and they did their job. They found out that these
16 things were impossible, not not probable, impossible.
17 Therefore, those trades never happened. They couldn't have
18 happened, not possible to happen.

19 I have absolutely plausibly pled that that's what
20 happened here. I haven't taken one deposition because we're
21 that far down the road and yet haven't had any real
22 discovery in this case. These are all pulled together based
23 on documents we got from FIM over in Europe through the UK,
24 not through any discovery here in this case.

25 So once we get started I think we've got a

1 plausible argument here that if you look at all those
2 statements and they're taking \$370 million in fees and they
3 did what they said they were going to do, in other words
4 Your Honor would have to accept the fact they didn't do what
5 they said they were going to do; that they weren't going to
6 go out and check. They weren't going to take those fees
7 because they were going to look. And that when they went
8 and they looked and they saw it was impossible, they turned
9 a blind eye because they had actual knowledge that no
10 trading was taking place.

11 So to suggest here today that they should somehow
12 walk makes no sense whatsoever. It -- let me add one other
13 element to that if I can, Your Honor, and it's troublesome.

14 They say this about front runner. All right.
15 Let's just -- I read what they said as sort of a classy way
16 of saying they're front running. They said, you know, look,
17 the guy's got the market making. He can get in front of the
18 trade. They didn't call it front running, but that's
19 essentially what they describe. One could argue whether --
20 let's assume that that's what they're saying. All right.
21 That's criminal. That's a criminal act. All right.

22 So they're saying, yeah, but it's okay because --

23 THE COURT: What's a criminal act?

24 MR. SHEEHAN: Front running is criminal. You're
25 not allowed to do that.

1 THE COURT: But that's not --

2 MR. SHEEHAN: You can go to jail for that.

3 THE COURT: But that's not what you alleged.

4 MR. SHEEHAN: No. What we alleged is they told
5 their people that the way he was able to get the consistent
6 returns is he had access to the market because of his
7 market-making operation. He could stay in front of the
8 trades. That's front running. That's what that is.

9 They say, well, that means there must have been
10 trading. So if there must have been trading we get the
11 benefit of safe harbor. How the -- how does that work?

12 You can say that what you're doing is criminal
13 and, therefore, you have a legitimate expectation that
14 entitles you to safe harbor.

15 THE COURT: I don't think that's quite what you're
16 alleging in the complaint.

17 MR. SHEEHAN: Well, it's certainly a plausible
18 argument from what we have alleged in the complaint. We've
19 alleged in the complaint that they reached out to their
20 people because they couldn't explain the consistent returns.
21 There is no way to explain it utilizing a split strike
22 conversion strategy. They knew that. They didn't even try.
23 All right.

24 So what we're saying is, is that they went out and
25 they came up and concocted some basis for suggesting that;

1 that if you read it and the clear reading of it is that
2 they're telling their customers they're engaging in front
3 running, right, at the end of the day -- which our
4 adversaries have argued here. They've said, oh, the trustee
5 said it was front running. Therefore, it's okay because
6 there must have been trading so that's okay with Judge
7 Rakoff's decision when, in fact, that can't be what Judge
8 Rakoff was saying.

9 Judge Rakoff couldn't have been saying that you
10 can engage in an illegitimate activity on a daily basis and
11 as long as you don't know it's a Ponzi scheme you can take a
12 walk. That can't be what he was saying.

13 And what we have here is through our complaint,
14 well plead plausible pleading is two guys getting together,
15 Sureti (ph) and Grosso, creating instrumentalities of fraud
16 starting with these two funds and utilizing those
17 instrumentalities including Kingate Management, Ltd, a
18 perverted FIM that started out legit and then perverted them
19 into an illegitimate operation and used all of those, why,
20 to get \$370 million into their pockets.

21 And by the way, with regard to -- I don't intend
22 to go into a lot of the arguments raised here this morning
23 by my adversary. I do believe on the issues of imputations
24 and others and equitable subordination that your decision in
25 Merkin called it right and we have that same situation here.

1 I don't see any difference between the two, quite frankly.

2 So at the end of the day what I'm suggesting to
3 Your Honor is, is that at this stage of the case, on a
4 motion to dismiss, when we've had all those pleadings that
5 we had that detail literally dozens and dozens of instances
6 where they had the opportunity and had the duty -- think
7 about this. They sold the duty. I'm not asking Your Honor
8 to impose a duty. They went out and sold it for \$370
9 million and said, we'll take care of you. We're going to do
10 all this checking. We're going to make sure it's all okay.

11 That's pled. They -- we plead that they didn't do
12 it. All right. And, therefore, they ended up being
13 willfully blind and had actual knowledge based upon all
14 that.

15 Here's the point, Your Honor, is at the end of the
16 day they're not Katz Wilpon. They're not unsophisticated
17 investors. These are guys who were in the industry on a
18 daily basis making a buck off of investing other people's
19 money. That alone should give them the duty to do something
20 and have a -- it's not whether or not they had any
21 obligation to investigate the broker independently for their
22 own investments. It's whether they had a duty because they
23 took other people's money and said they would invest it, and
24 they should do something with it other than just invest it
25 and do nothing.

1 So at the end of the day, Your Honor, our position
2 is is that our complaint adequately pleads plausible
3 allegations with regard to what we can establish at trial
4 with regard to both actual knowledge predicated upon the
5 impossibility of these trades, all right, that they should
6 and did know about. And when we take their depositions they
7 will -- we will find that out. And when we go to trial I
8 think we have enough of it for a fact finder to find that
9 they willfully blinded themselves and actually knew that
10 these trades were impossible and as a result were not
11 entitled to the safe harbor.

12 Thank you.

13 THE COURT: Thank you.

14 MR. LOIGMAN: Your Honor, I heard your admonition
15 before and I'll be brief.

16 Mr. Sheehan was very animated in pointing to us --

17 THE COURT: He's over there.

18 MR. LOIGMAN: Right. And saying --

19 (Laughter)

20 MR. LOIGMAN: -- repeatedly, repeatedly --

21 MR. SHEEHAN: Thank you, Your Honor.

22 MR. LOIGMAN: -- repeatedly that we got, that
23 these two funds got \$370 million, kept pointing at us and
24 saying, you got \$370 million. You sold a duty. Well, Mr.
25 Sheehan is completely incorrect about that. The funds

1 didn't get a single dime of that \$370 million. The funds
2 were the ones who paid that \$370 million. They paid it to
3 their investment managers.

4 And what Mr. Sheehan has done is explained exactly
5 what imputation should not apply here because to the extent
6 he's saying they sold a duty that they didn't fulfill, they
7 acted adversely to the very funds who were paying them the
8 amounts, paying them that \$370 million for them to perform
9 those duties.

10 And talking about those duties, what Mr. Sheehan
11 alleges -- and then when he goes on to say that they had all
12 of this knowledge, in the complaint he repeatedly alleges
13 that they didn't fulfill those duties. And Your Honor won't
14 hear me arguing with that. I wish they had fulfilled those
15 duties and that the Kingate funds hadn't lost all of that
16 money. But in paragraphs 128, 129, 132, 133, the trustee
17 repeatedly alleges that the investment managers did not
18 fulfill any due diligence obligations they may have had to
19 the funds. The funds, in contrast, had no obligations to
20 BLMIS to investigate its broker, to study any account
21 statements. These are obligations that he's trying to
22 create on the part of the funds that don't exist.

23 And an important fact to keep in mind, and one I
24 mentioned before, Your Honor, is that the funds sole
25 investment, their sole investment was in BLMIS. So when the

1 investment managers put their money into BLMIS, the reason
2 why there was imputation of Merkin is because there was some
3 benefit to the funds of investing more in BLMIS. And in
4 this case there's absolutely no benefit to the funds of
5 investing in BLMIS. All they did was lose more money.
6 Money would come in. They lost it to Madoff. There was no
7 benefit whatsoever.

8 I think the trustee here and Mr. Sheehan has
9 actually made out a strong argument for why imputation
10 should not apply here.

11 Very briefly addressing a few other points he
12 raised, he points to Katz Wilpon as an example of where
13 there was willful blindness and says the simple real estate
14 baseball investors in Katz Wilpon are very different than
15 the investors here.

16 First, I'll remind the Court that Katz Wilpon are
17 net winners. All right. They didn't lose money in Madoff.
18 So there's a lot more basis for assuming that they knew
19 something was going on.

20 Secondly, Katz Wilpon were not the simple people
21 that Mr. Sheehan paints them to be. I'll remind the Court
22 that they actually set up their own hedge fund, Stomino (ph)
23 Sterling Partners. You remember their name was Sterling
24 Partners. And their own hedge fund advised them that they
25 would not invest in Madoff because it wouldn't meet the

1 hedge funds due diligence requirements. These weren't
2 unsophisticated investors by any means.

3 Next, Mr. Sheehan points to the standard that
4 Judge Rakoff set forth in Comad with respect to 546(e). And
5 I submit the standard couldn't be any clearer. It says,
6 actual knowledge that they were -- there were no securities
7 transactions being conducted.

8 And what Mr. Sheehan said is, well, if they should
9 have figured out that there was something going wrong there.
10 That's not the standard at all. Even if they thought there
11 was some reason why Madoff was getting better returns and
12 maybe he was doing something different than other people in
13 the market, an allegation for which there's no basis, but
14 even that doesn't say no securities being transacted.
15 Remember, the 546(e) is tied to whether there's a securities
16 contract. All right. It's one of the basis for 546(e).

17 And what Judge Rakoff was saying is that if
18 everybody knew there were no securities being transacted,
19 there would be no underlying securities contract. But so
20 long as the Kingate funds or their managers in that instance
21 believed that there were securities being transacted, there
22 is that underlying securities contract, 546(e) applies, and
23 the only way to get around it is that actual knowledge.

24 And unless Your Honor has any further questions --

25 THE COURT: No.

1 MR. LOIGMAN: -- I have nothing to add.

2 THE COURT: Thank you.

3 MR. LOIGMAN: Thank you, Your Honor.

4 THE COURT: I'll reserve decision. Thank you.

5 Did you want to --

6 MS. HARRIS: No.

7 THE COURT: Oh, I thought I saw you stand. Okay.

8 Thank you very much.

9 (A chorus of thank you)

10 (Whereupon, these proceedings concluded at 11:19 AM)

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C E R T I F I C A T I O N

I, Sherri L. Breach, CERT*D-397, certified that the
foregoing transcript is a true and accurate record of the
proceedings.

Sherri L
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